Indonesia

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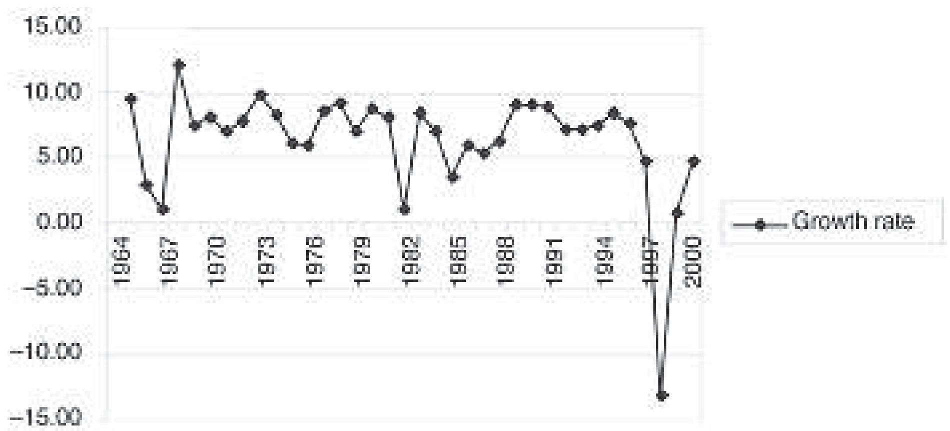
1 Introduction

When the New Order came to power in Indonesia in 1965, the country was undergoing a severe economic crisis. Between 1961 and 1965, the economy had stalled, with Net Domestic Product rising only slightly from Rp 407billion to Rp 430billion in 1960 prices. At the same time, the country's export earnings had fallen dramatically from US$ 750million to US$ 450million, making it virtually impossible for the country to meet its burgeoning foreign debt commitments. Inflation was also spiralling out of control, caused by excessive printing of money to fund growing government budget deficits. In 1960 inflation stood at 20 per cent per annum but by 1965 it had risen to almost 600 per cent. Poverty was also very severe, with 61 per cent of the population on Java and 52 per cent of the population outside Java considered 'very poor' by one estimate. Although United Nations human development scores are not available for Indonesia during the mid-1960s, its socio-economic indicators were poor, suggesting that its level of human development was low (Arndt 1967: 130–1; Hill 1996: 3–5). So severe were Indonesia's economic problems that one leading economist at the time argued that 'Indonesia must surely be accounted the number one failure among the major underdeveloped countries' (Higgins 1968, as quoted in Hill 1996: 1). At the same time, the country was politically unstable, reflecting intense rivalry between communist and radical nationalist forces on the one hand, and counter-revolutionary forces on the other. While this rivalry led to only minor episodes of serious violent conflict during the late 1950s and early 1960s, it resulted in massive violence once the New Order took power. In an effort to eliminate its primary political rival (the Indonesian Communist Party, PKI), the army sponsored the murder of suspected communists during 1966, resulting in hundreds of thousands of deaths.

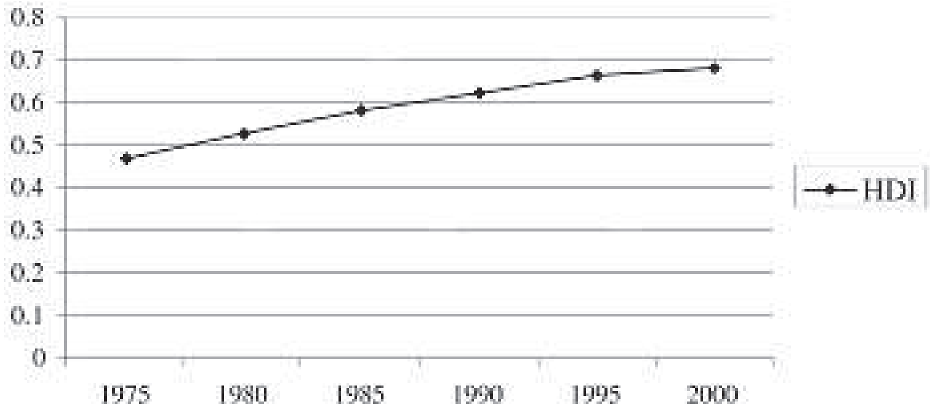
Beginning in the late 1960s, the country began a process of turnaround. On the one hand, it experienced strong economic growth and a

Figure 1 **Indonesia: Real economic growth, 1965–2000**



Source World Bank, World Development Indicators CD-Rom.

Figure 2 **Indonesia: human development index, 1975–2000**



Source UNDP Indonesia (2001: 6).

significant improvement in human development over the next three decades (Figures 1 and 2). Indeed, so successful was the country in these respects that by the early 1990s, the World Bank had identified it as one of East Asia's 'miracle' economies (World Bank 1993a). On the other hand, the country achieved relative political stability. To be sure, there were episodes of severe violent conflict during this period. The country's invasion of East Timor in 1975 resulted in the death of, by some estimates, as many as one-third of the East Timorese population, as well as several thousand Indonesian troops (Schwarz 1994: 205). The government also became engaged in armed struggles against separatist movements in Aceh, Irian Jaya and (after 1975) East Timor. At times, these regions – particularly Aceh and East Timor – were effectively war zones. There were also occasional riots, demonstrations and other events outside these regions that turned bloody, such as the Malari riots in Jakarta in January 1974 (in which 11 people were reportedly killed), the Moslem demonstration in Tanjung Priok in 1984 (in which at least 30 and possibly more than 100 people were killed), and the inter-communal hostility in West Kalimantan in 1996–7 (McDonald 1980: 138; Mackie and MacIntyre 1994: 53; Young 2001). But the country successfully avoided more widespread violent conflict and, in particular, the sorts of violent conflicts, such as civil wars and wars with neighbouring countries, that have severely hampered prospects for economic development in countries such as Angola, the Sudan and Cambodia.

With the onset of the Asian crisis in 1997, the pendulum again swung back towards poor economic performance and increased violent conflict. The collapse of the rupiah in 1997–8 led to a massive contraction in the economy, widespread corporate bankruptcy, and dramatic increases in inflation, poverty and unemployment (Robison and Rosser 1998; Pincus and Ramli 1998). Having achieved 'lower middle income' status in the World Bank's country rankings in the 1990s, Indonesia once again became classified as a 'low-income country'. While the country's level of human development has continued to improve in the period since the crisis, the process of economic recovery has been slow. At the same time, the country has experienced increased violent conflict, with renewed fighting in Aceh, a bloody transition to independence in East Timor, the emergence of severe ethnic and religious conflict in the Moluccas, and widespread rioting throughout the country particularly in the first part of 1998. This has not resulted in a full-scale reversal of the gains made *vis-à-vis* turnaround made during the previous three decades but it has led to a partial reversal.

The purpose of this article is to explain Indonesia's performance regarding the turnaround in independence in 1949 and the late 1990s[1] and to examine the role of donors in shaping this performance. I argue that Indonesia's performance in the turnaround has reflected the orientations, abilities and political skills of the country's political leaders during this time, particularly its two Presidents, Sukarno and Suharto; struggles between the main social and organisational forces within the country and the emergence of new social forces; the nature of the country's geopolitical and geo-economic environment; and 'chance' factors such as economic shocks. In respect of the role of donors during this time, I argue that donors contributed to the process of initiating turnaround in the 1960s and 1970s through the provision of economic policy advice and much-needed finance. I suggest that they also contributed to the process of reversal by encouraging the pattern of financial sector reform that contributed to the crisis.

In presenting this explanation, I begin by examining the origins of Indonesia's economic, political and social problems in the mid-1960s (Section 2). I then examine the political economy of Indonesia's 'turnaround' from the late 1960s onwards (Section 3), the origins of its economic and political crisis in the late 1990s (Section 4), and the role of donors during both the turnaround and partial reversal phases (Section 5). In the final section of the article, I examine the country's prospects for further progress in economic growth, human development, and political stability in the future.

2 The origins of economic turmoil and violent conflict in Indonesia in the 1950s and 1960s

The country's economic and political problems during the mid-1960s reflected in part President Sukarno's limitations as an economic manager. Sukarno was a skilful politician and nation-builder. But as McDonald (1980: 68) has noted, he was 'a dilettante in economic policy'. Notwithstanding the country's rapid economic decline during the early 1960s, he became increasingly unrealistic in terms of the economic policy agenda that he pursued. Sukarno's commitment to Indonesian nationalism in the political realm translated into an anti-imperialism in the economic realm that worsened the economic crisis. As Bresnan (1993: 54) has argued, 'Sukarno simply did not understand the roots of the economic deterioration that was eroding the people's welfare'.

But, while Sukarno's limitations as an economic manager undoubtedly contributed to the country's economic problems during the mid-1960s, these problems had deeper social and political roots. More specifically, they reflected the bitter struggle for power between radical nationalist and communist forces on the one hand, and counter-revolutionary forces on the other, that began during the 1945–9 struggle for independence. At one level, this was a struggle between particular organisations, with the Indonesian army being the most important organisation on the counter-revolutionary side, and the Indonesian Communist Party (PKI) being the most important organisation on the communist and radical nationalist side. At another level, however, it was a struggle between particular class interests, with the army being aligned with propertied elements in the countryside, the country's major ethnic Chinese entrepreneurs, and foreign capitalists (Anderson 1983; Robison 1986) and the PKI being aligned with the Indonesian peasantry and the labour movement (Wertheim 1969; Hadiz 1997). This struggle was central to Indonesian politics during the periods of parliamentary rule and Guided Democracy that followed independence.

During the early to mid-1950s, the rivalry between these two sets of forces posed relatively little threat to the country's economic development and political stability, as neither group was strong enough to seize power. But by the late 1950s, it had become a serious threat to both, as both sets of forces began to assert themselves, the former following the army's successful quelling of a series of regional rebellions and a process of internal reform that consolidated power in the hands of military headquarters in Jakarta, and the latter following the PKI's strong performance in a number of elections. A key moment in this respect came in 1957. Provoked by Dutch intransigence over the future of West Irian (which had remained in Dutch hands after independence), trade unions aligned with the PKI began seizing control of Dutch assets. Although the Sukarno government initially tried to clamp down on these seizures, widespread popular support for the move forced it to accept the *fait accompli* and nationalise the assets (Legge 1972: 293). A few years later, PKI-led trade unions also seized British and American assets, again leading to forced nationalisations. Another key moment came in the early 1960s with the introduction of new land reform legislation. Early attempts to implement the new laws foundered because of opposition from landholders who dominated the local boards responsible for land reform and were able to use their positions and close relationships with local government and military officials to prevent redistribution of their lands. In 1963, the Indonesian Peasant Front, a peasants' organisation aligned with the PKI, began encouraging peasants to unilaterally seize and redistribute land, an action that triggered violent clashes in a number of rural areas (Crouch 1988: 63–4; Robison 1993).

These developments contributed to the economic and political problems of the mid-1960s in three ways. First, they provoked widespread capital flight. The seizure of foreign assets and land signalled to mobile investors that their investments were no longer secure and that it was sensible for them to exercise their exit option. Many did just that (Winters 1996: 47). Second, these developments provoked Sukarno into pursuing an economically disastrous strategy of mass mobilisation around a nationalistic agenda in an attempt to maintain national unity (Feith 1963). One part of this strategy was the pursuit of prestige development projects such as the building of the five-star Hotel Indonesia, a new national monument (*Monas*) and the prestigious Sarinah department store in Jakarta. Another was 'Confrontation' with Malaysia over the planned formation of a federal Malay state. While these measures served a short-term political logic, they contributed to a severe blowout in the government budget. Third, these developments increased class-based tension between the army and the PKI. The army assumed control of most of the nationalised assets, and as such, was now in a directly antagonistic class-based relationship with the peasants and workers who worked in these enterprises, many of whom were members of the PKI. Because many army officers were landholders, it was in a similar position in relation to the land issues.

In the end, the crises created by these developments engulfed Sukarno and his government. A failed coup attempt involving sections of the military and the PKI during September and October 1965 precipitated Sukarno's removal from office, the downfall of his government, the rise of the military-backed 'New Order' under Major-General Suharto, and the violent annihilation of communist and radical nationalist forces during 1966.

3 The political economy of 'turnaround'

3.1 Initiating turnaround, 1966–70

When the New Order came to power, it immediately set about overcoming the economic crisis. Together with the International Monetary Fund (IMF) and the World Bank, the government devised a programme of economic stabilisation and rehabilitation. Initially, its focus was on stabilising the economy through rescheduling Indonesia's massive foreign debts, attracting foreign aid to cover essential imports, and reducing inflation through stringent monetary and fiscal policies. Once it had stabilised the economy, its attention turned to rehabilitating the economy through measures designed to attract investment and promote growth. These included the easing of bank credit, reductions in interest rates, the introduction of new foreign and domestic investment laws, increased development spending, and the formulation of a five-year development plan. Both the stabilisation and rehabilitation measures were remarkably successful. By 1969, inflation had been brought under control and by 1970, the ratio of exports to gross domestic product (GDP) had recovered to the same level as in 1960. In addition, the economy began growing strongly again in the late 1960s, contributing to a rapid recovery in real national income *per capita* (McDonald 1980: 79; Rosser 2002: 40–1).

Just as Indonesia's economic and political crises during the mid-1960s reflected in part Sukarno's limitations as an economic manager, so the country's initial progress towards turnaround during the late 1960s partly reflected Suharto's leadership. Suharto was just as much a dilettante in economic matters as Sukarno. But he recognised, perhaps because of Sukarno's experience, that his government's survival depended on its ability to revive the economy and promote capitalist development. More specifically, he recognised that it depended on the introduction of the sort of economic policies advocated by a group of professional economists based at the University of Indonesia, collectively known as the technocrats. Liddle (1991: 405–6) has suggested that Suharto sought the technocrats' advice because 'they were well trained neoclassical and development economists, practitioners of the most advanced of the social sciences, possessors of genuine science in a still very unscientific society'. More likely, however, he sought their advice because, with both Western donors and mobile investors signalling a desire for a market-oriented shift in the government's economic policies (Winters 1996: 47–94), he realised that the government was unlikely to attract the financial assistance and investment that it needed to overcome the economic crisis unless the technocrats were given a key role in economic policy making.

At the same time, however, the country's initial progress towards turnaround was not simply a reflection of Suharto's calculations and instincts. More fundamentally, it reflected the political victory of counter-revolutionary forces over radical nationalist and communist forces. The victory of the former set of forces laid the basis for the country's strong initial performance *vis-à-vis* turnaround in two ways. First, it made it politically easier for the government to reorient economic policy away from the anti-imperialist and interventionist strategy of the Sukarno years and towards the market-oriented strategy advocated by the technocrats. With communist and radical nationalist forces defeated, the New Order faced little domestic opposition to reversing the policies that had served to provoke capital flight such as the nationalisation of Dutch and other foreign assets and the PKI-inspired land reform programme and introducing new policies aimed at providing a more secure and attractive investment environment. Second, the victory of counter-revolutionary forces over radical nationalist and communist forces provided a strong incentive for the US government and other Western governments to assist the New Order in overcoming the economic crisis. The New Order gained power at a time when the Vietnam War was just beginning and there was widespread fear within the USA and other Western countries that communism would spread, domino-like, throughout the rest of Southeast Asia. Specifically, the USA had been very concerned about the growing strength and influence of the PKI in Indonesia during the late 1950s and early 1960s and was worried that it might at some point take power (Ricklefs 1981: 259–69). When the New Order seized power in 1965, the USA and other Western governments were thus keen to provide it with the advice and assistance it needed to consolidate its rule.

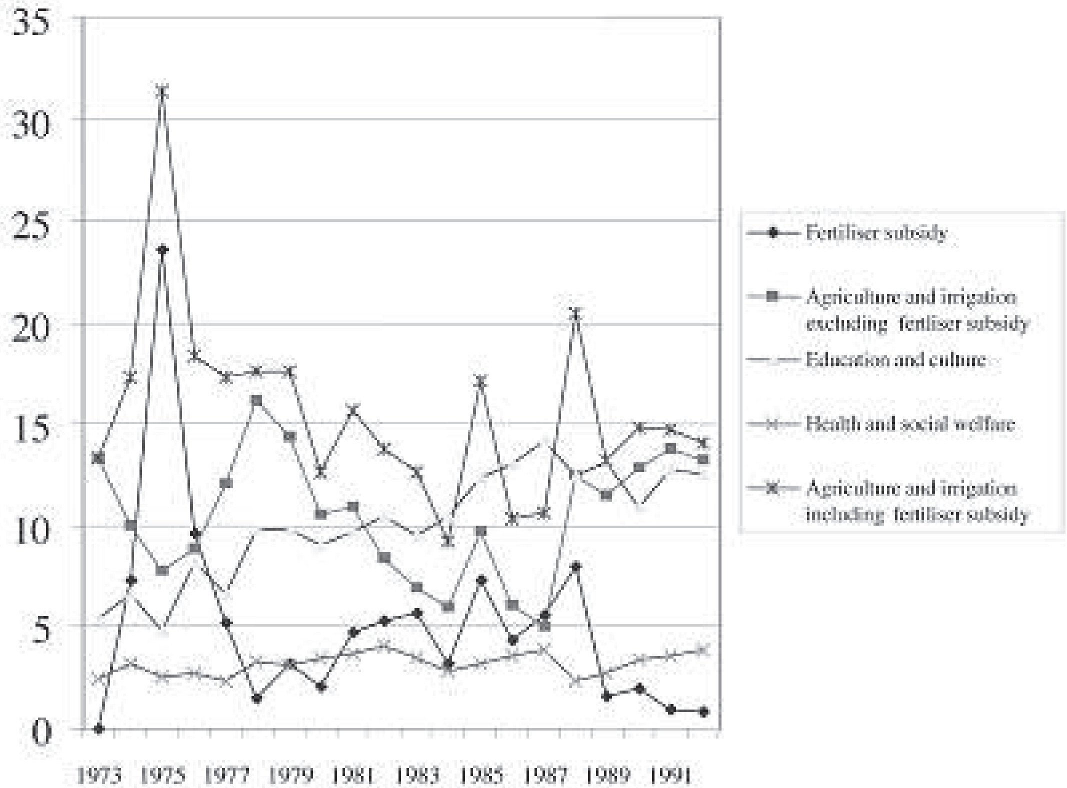
3.2 **Achieving and sustaining turnaround, 1970–7**

Over the two and a half decades, the New Order made even further progress. The economy grew strongly during the 1970s, as Figure 1 shows. At the same time, the country also made marked progress in terms of human development, with its human development index (HDI) score rising from 0.465 in 1975 to 0.526 in 1980. The country also maintained political stability, not experiencing severe violent conflict outside of those regions in which separatist conflicts were raging such as East Timor and Aceh.

Two factors facilitated this progress *vis-à-vis* turnaround. The first of these was that the country benefited from a number of favourable economic shocks (Temple 2004: 153). For instance, Indonesia was able to benefit from the development of new high-yielding varieties of rice by the International Rice Research Institute (IRRI) in the Philippines in the 1960s because of the importance of wet rice agriculture to its economy at the time and the fact that the new rice varieties were particularly suitable to Indonesia's conditions. As an oil exporting economy, Indonesia also benefited enormously from the 1970s oil boom. The massive increase in government revenues that the oil boom generated provided the government with huge funds to pursue its development agenda. Finally, the country also benefited from the fact that it was part of the fastest growing economic region in the world between the 1960s and 1990s. This proved particularly important during the late 1980s and early 1990s when, following the collapse of international oil prices, the government desperately sought to attract foreign investment in export-oriented manufacturing industries from its neighbours. But it was also important during the early New Order period, when it was trying to attract investment, from Japan in particular, into the country's natural resource industries. All of these factors were crucial in promoting economic growth and improved levels of human development in Indonesia during the 1970s, 1980s and 1990s.

The second factor that facilitated progress towards turnaround during this period was Suharto's successful management of the politics surrounding the process of economic reform during the 1960s and 1970s. In part, this successful management relied on the use of authoritarian political controls. In the early 1970s, the New Order emasculated the political parties by forcing them to submit to a dramatic simplification of the party system and interfering directly in their leadership elections (McDonald 1980). At the same time, it established a series of corporatist-style organisations under the control of Golkar (the government's electoral vehicle) ostensibly to represent social groups such as women, labour, domestic business, and peasants but in reality to control them (MacIntyre 1990). In the mid-1980s, it forced all mass organisations to accept Pancasila, the state ideology, as their 'sole foundation', limiting these organisations' scope for ideological independence (Adnan 1990). Finally, it restricted freedom of the press through a punitive system of press licensing and editorial interference (Hill 1994; Lubis 1993). By limiting social groups' freedom of organisation and expression, the New Order dramatically limited the extent to which these groups could organise themselves and criticise

Figure 3 **Government expenditure on agriculture, health and education as a proportion of total development expenditure**



Source Woo *et al.* (1994).

government policy. As such, these measures made it politically easier for the New Order to pursue its programme of capitalist development.

At the same time, Suharto was also able to reduce opposition to his government's development strategy by co-opting social groups that were critical of this strategy, or which had the potential to become so in the future. While the economic reforms of the late 1960s proved successful in attracting foreign and ethnic Chinese capital back into the country, they created distributional tensions in two ways: by making it difficult for many small indigenous capitalists to survive – as Palmer (1978) has noted, the late 1960s and early 1970s saw many small indigenous entrepreneurs go to the wall – and by doing little to benefit Indonesians who lived in rural areas and who depended on agriculture for their livelihoods. By the early 1970s, the New Order's development strategy was being widely criticised, particularly by student groups, journalists and indigenous capitalists, for promoting foreign economic domination, corruption, and growing inequality.

Initially Suharto did little to assuage the concerns of these critics. But following widespread rioting in Jakarta in early January 1974 after a visit by the Japanese Prime Minister, he responded with a range of measures aimed at promoting indigenous businesses. These included the introduction of a variety of preferential credit programmes for small business people and rural entrepreneurs; a dramatic expansion in the role of state-owned enterprises in the economy; and the introduction of a programme to promote indigenous businesses by giving them preferential access to government supply and construction contracts (Robison 1986: 164–8). In a number of cases, these measures failed to produce significant benefits for indigenous business groups – for instance, much of the credit intended for small indigenous entrepreneurs under preferential credit programmes is believed to have been diverted to well-connected Chinese entrepreneurs (Jenkins 1981). But by co-opting key sections of the indigenous population such as the politico-bureaucrats (who benefited from increased state control over the economy) and larger indigenous entrepreneurs (who were the prime beneficiaries of the programme to provide preferential access to government supply and construction contracts), they served to ameliorate indigenous criticism of the government's development strategy and, in this way, facilitate the process of turnaround.

At the same time, Suharto used some of the country's newly found oil wealth to make substantial investments in agriculture, and public services such as education and health, all areas in which indigenous Indonesians were the major beneficiaries (Figure 3). During the 1970s and early 1980s, his government made a great effort to increase agricultural production by promoting the use of high-yielding rice varieties and subsidising the use of fertilisers and other key inputs to the production process. Although this effort was unsuccessful at first (Hansen 1978), by the 1980s, the country had achieved self-sufficiency in rice. In the education sector, the government funded a massive expansion of the school system, particularly the primary school system (Hull and Jones 1994: 164), contributing to significant improvements in national education and literacy levels. It also funded a big expansion of the public health system, although as Hill (1996: 212) has noted, this appears to have been relatively ineffective in promoting improved social welfare outcomes: 'public expenditure in the health sector', he says, was 'less effectively focused and less pro-poor and pro-rural than that of education'. Again, the benefits of these measures were not evenly distributed. For instance, the government's agricultural policies appear to have disproportionately benefited larger farmers because they were better placed to adopt the new rice technologies, given their greater access to preferential credit and other key inputs (Husken and White 1989: 236). Nevertheless, by co-opting key sections of the rural population and producing at least some material benefits for the poor, they served to reduce potential political opposition to the government's development strategy. In this way, like the measures at promoting indigenous business that were discussed above, they served to facilitate strong performance regarding the turnaround.

These investments also had the effect of reducing the scope for violent social conflict in Indonesia. The success of the government's agricultural modernisation programme was particularly important in this respect. Political unrest in Indonesia has often been related to rapidly rising urban food prices. By ensuring reliable supplies of rice to urban areas at stable prices, the New Order's agricultural modernisation programme served to limit the scope for political unrest in the cities. At the same time, its agricultural policies also served to reduce the scope for political unrest in rural areas. Rural farmers in Java had been one of the key sources of support for the PKI and, although the PKI was banned and many of its members were jailed or murdered in the mid-1960s, the New Order feared a resurgence of radicalism and instability in these areas. By delivering material benefits to rural farmers, albeit benefits that were unevenly distributed, this programme served to placate elements that might otherwise have supported radical political activity and contributed to violence (MacIntyre 1999: 265–7). At the same time, the expansion of the educational system enabled the New Order to promote greater ideological attachment to the nation-state through the provision of school and university courses in Panacasila, the state ideology, and the compulsory use of the national language, in turn reducing the scope for violent opposition to the New Order based on regional identities.

4 The political economy of 'reversal'

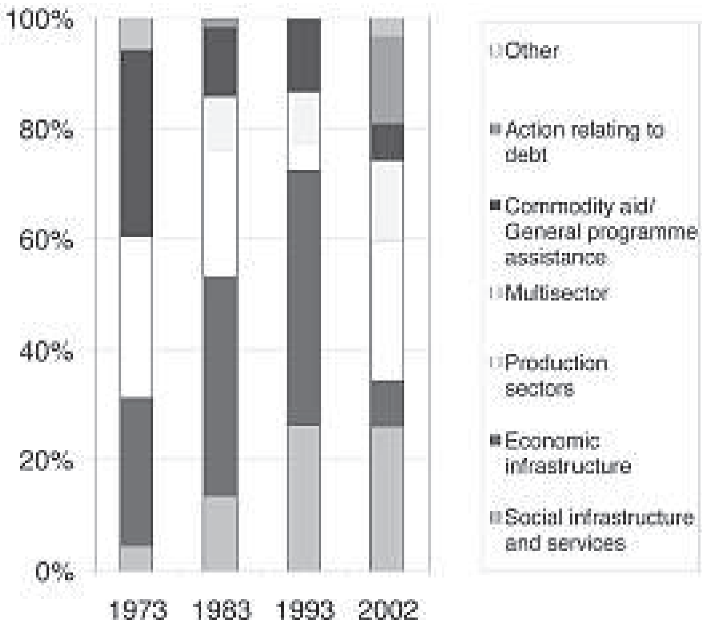
As noted earlier, the onset of the Asian economic crisis had a devastating impact on Indonesia's economy and produced a partial reversal of the country's gains *vis-à-vis* turnaround during the previous three decades. At one level, this outcome reflected Suharto and the technocrats' mismanagement of the process of financial sector liberalisation over the previous decade. As Radelet and Sachs (1998: 20) among others have pointed out, the New Order's financial sector reforms during this period were 'haphazard and partial'. While the financial sector was extensively deregulated during the 1980s and early 1990s, relatively little progress was made in establishing strong systems of prudential regulation and financial sector supervision. The government introduced new regulatory frameworks for the banking system and the capital market but regulators lacked the capacity to properly supervise the financial sector and ensure strong enforcement of the new regulatory frameworks through administrative or legal mechanisms. The result was imprudent and risky lending on the part of banks and speculative stock and bond investments on the part of portfolio investors. This, in turn, contributed to problems with bad debts and insolvency in the banking system and volatility in the capital market. In short, it left Indonesia's financial system vulnerable to the sort of financial panic that struck the country from the middle of 1997.

More fundamentally, however, the devastating impact of the crisis on Indonesia's economy reflected shifts in the structure of power and interest during the 1970s and 1980s and the implications that this had for the process of financial sector liberalisation. The 1970s and 1980s witnessed the emergence of a number of large private sector conglomerates, most of which had close family or personal connections to senior political and bureaucratic figures. The most prominent of these were the business groups owned by members of the Suharto family or Suharto's friends: the Bimantara group (which was owned by Bambang Trihatmojo, one of Suharto's sons); the Humpuss group (which was owned by Hutomo Mandala Putera, another of Suharto's sons); the Citra Lamtorogung group (which was owned by Siti Hardiyanti Rukmana, Suharto's eldest daughter); the Salim group (which was owned by Liem Sioe Liong, one of Suharto's closest friends); and the Bob Hasan group (which was owned by Bob Hasan, Suharto's golfing buddy). Most of these business groups had grown rapidly as a result of privileged access to subsidised state bank credit, import licences, forestry concessions and other forms of state largesse, secured through their political connections (Robison 1986; Schwarz 1994). In the early days of the New Order, the 'politico-bureaucrats' who occupied the military, the bureaucracy, and other sections of the state apparatus were by far the dominant domestic element in the coalition of counter-revolutionary forces that underpinned the New Order. By the mid-1980s, however, the conglomerates had become a key element in this coalition, forming what one observer called a 'pact of domination' (Robison 1988: 71) with the politico-bureaucrats.

The emergence of the conglomerates was to have a significant influence on the pattern on financial sector liberalisation during the 1980s and 1990s. In general, the politico-bureaucrats and the conglomerates had a common interest in preserving state domination of the economy – for the politico-bureaucrats, state domination of the economy meant control over the allocation of state bank credit, concessions, licences and other facilities and access to the rent-generating opportunities that this provided, while for the conglomerates, it meant continuing to have privileged access to these facilities. But the two had different interests in relation to state control of the financial sector. Whereas financial sector deregulation threatened the politico-bureaucrats' control over the allocation of financial resources, it promised a variety of new business opportunities for the conglomerates in activities such as banking and securities trading. When international oil prices collapsed in the mid-1980s and the government came under structural pressure to deregulate the economy, the conglomerates lobbied for financial sector deregulation whereas the politico-bureaucrats at the central bank resisted at least certain elements of the deregulation programme. It was only in relation to regulatory and institutional reform in the financial sector that both the politico-bureaucrats and the conglomerates maintained a united front of opposition. Both stood to lose from regulatory and institutional reform, the politico-bureaucrats because such reform would mean less scope for rent-seeking and corruption and the conglomerates because it would mean greater transparency and accountability to financial regulators and to outside investors. With the politico-bureaucrats and the conglomerates retaining their political dominance – in particular their control over the state apparatus – throughout this period, they were able to prevent financial sector reform from encompassing regulatory and institutional reform (Rosser 2002; Rosser *et al.* 2004).

At the same time, Indonesia was also affected by changes in its geopolitical and geo-economic context. As Winters (1999: 35–6) has pointed out, two developments in this respect were particularly important in creating the conditions for the economic crisis in Southeast Asia. The first of these was a dramatic shift in the nature of capital flows to developing countries. By the late 1990s, private flows of capital had replaced foreign aid as the main source of investment capital for developing countries. At the same time, the dominant forms of private capital flows to these countries had become highly mobile commercial loan and portfolio capital flows. Dependence on these types of capital flows in turn placed Southeast Asian countries at increased risk of,

Figure 4 **Sectoral allocation of aid to Indonesia, 1973–2002**

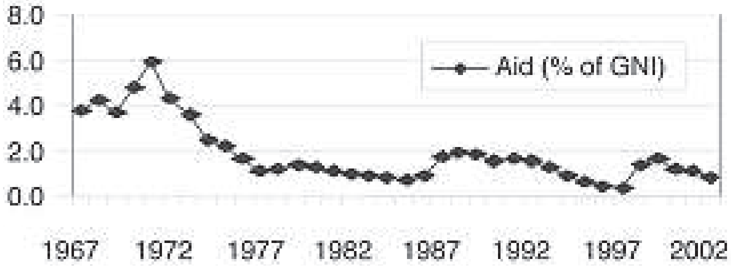


Source OECD, Creditor Reporting System.

at some point, a panicked withdrawal of capital. The second development was a shift in the interests of Western governments regarding the region. With the end of the Cold War, the USA and other Western governments no longer viewed East Asian countries as a key bulwark against the communist enemy. This in turn meant that, as Winters (1999: 35) noted, these governments became 'much less willing to allow trade and investment issues to take a back seat to security concerns'. In the Indonesian context, the result was that Western governments and international organisations, particularly the IMF, were unwilling to simply bail out what they saw as a corrupt and highly interventionist regime. While they were willing to provide large amounts of aid to Indonesia during the crisis, they also sought a *quid pro quo* in the form of wide-ranging economic reform.

The violence that has occurred in Indonesia since the onset of the crisis needs to be understood in terms of the political consequences of the economic crisis. The crisis dramatically weakened the government's capacity to maintain political order through co-optation and repression. On the one hand, the crisis robbed the government of a significant proportion of the patronage resources that it needed to reward political supporters and co-opt political opponents by causing severe fiscal problems. On the other hand, the crisis provoked widespread criticism of the military and police for their role in human rights abuses under the New Order, something that made them increasingly reluctant to respond to expressions of political opposition with force, at least outside regions undergoing separatist conflicts (Bourchier 1999). In this context, political space opened up for groups that were marginalised under the New Order to reassert themselves. Within weeks of Suharto's downfall, peasant groups began to unilaterally seize back land that they felt had been wrongfully taken away from them by the government or business groups under the New Order leading in a number of cases to clashes with security forces and gangs of hired thugs. In various parts of the country, peasant and other groups have been involved in the kidnapping, hostage-taking or even murder of local political leaders as they have vented years of pent up frustration at the actions of these individuals in relation to land. At the same time, separatist movements in Aceh and East Timor and their supporters renewed their calls for independence, leading to renewed fighting and violence in Aceh and the bloody withdrawal of Indonesian troops from East Timor in 1999. Violence

Figure 5 **Aid as percentage of gross national income**



Source World Bank, World Development Indicators CD-Rom.

has also been increasingly triggered by 'turf wars' between the military and police over control of protection rackets and other illegal activities at the local level, following the formal separation of the two organisations as part of the post-Suharto reforms. On some occasions, the military also appears to have provoked violence within particular regions in order to destabilise governments whose policies they have opposed (Rosser *et al.* 2004).

5 The role of donors

The role of donors in relation to Indonesia's performance *vis-à-vis* turnaround has varied considerably over time, being much more significant and/or positive in some periods than in others.

Donors played a relatively positive and significant role in the initiation of turnaround in the mid- to late 1960s. First, they provided much of the finance required to stabilise and rehabilitate the economy. The annual aid pledges made by members of the Intergovernmental Group on Indonesia (IGGI), a grouping of the country's main foreign donors that was established just after the New Order came to power, were instrumental in bringing inflation under control during 1966–8. Channelled mainly through the Export Bonus (EB) scheme, these funds were used by the Indonesian government to finance the importation of various key commodities, and in doing so reduce their prices. At the same time, donor funds provided a key source of finance for more development-related activities after stabilisation was achieved, being used in particular to fund the rehabilitation and development of economic and social infrastructure, agricultural and other forms of production, and the provision of social services (Figure 4). Between 1966/7 and 1973/4, donor funds accounted for significantly more than half the government's development budget. As Figure 5 illustrates, Indonesia was not highly dependent on aid during this period, at least not in comparison with some of the other countries examined in this study during their periods of turnaround. Nevertheless, overall aid levels were crucial insofar as they provided the government with the resources that it needed for price stabilisation and economic rehabilitation. Second, donors – and, in particular the IMF – provided crucial economic policy advice to the Indonesian government. As noted above, the IMF played a key role in assisting the technocrats devise the economic policy programme that stabilised the economy in 1965–6 and promoted investment and economic growth thereafter.

During the 1970s and early 1980s, donors played a much less significant role in relation to the country's performance regarding the turnaround. As Figure 5 shows, donor funding to Indonesia fell significantly as a percentage of gross national income (GNI) during this period, reflecting the effects of the oil boom. In 1974/5, foreign aid fell to 24 per cent of the government's development budget, although it subsequently increased in 1978/9 to around 40 per cent of the development budget (Booth and McCawley 1981: 141). At the same time, while the IMF and other donors continued to provide policy advice to the government, the government was generally less receptive to this advice than it had been in the late 1960s. The oil boom dramatically reduced the structural leverage that foreign donors exerted over the Indonesian state: while their ability to withhold aid was not affected by the oil boom, the state's access to alternative sources of investment funds meant that any threats on their part to reduce aid were not nearly as constraining on policy-makers (Winters 1996: 95–6). This decline in receptiveness is reflected in the nature of the government's economic policies during this period, which were generally much more statist/interventionist in character than donors apparently preferred (Rosser 2002: 59–60; Winters 1996: 144–55).

During the 1980s and 1990s, donors became more influential again and had a more significant (although arguably less positive) impact on the country's performance *vis-à-vis* turnaround. The collapse of international oil prices increased the need for the country to mobilise new sources of investment funds, particularly from the private sector but also from donors. Donors responded by increasing their aid allocations for the country – as Figure 5 shows, foreign aid roughly doubled as a percentage of Indonesia's GNI during the late 1980s. Within this context, influence over economic policy shifted away from the politico-bureaucrats and the conglomerates and towards donors and private investors. Donors used their new influence to encourage the government to deregulate the Indonesian economy, particularly in the trade, investment and finance sectors (World Bank 1988). After the government introduced a range of deregulatory reforms during the 1980s, particularly in the financial sector, they encouraged it to take the reform process further by introducing various prudential safeguards and other institutional reforms (World Bank 1993b). It is in this respect that donors had a less than positive influence *vis-à-vis* turnaround during this period. By encouraging financial sector deregulation before adequate prudential safeguards and institutional reforms were in place, they contributed to the 'haphazard and partial' pattern of financial sector reform (Radelet and Sachs 1998) that contributed to the onset of the 1997–8 financial crisis.

Donors' role in the management of the crisis was mixed. In the midst of the crisis, donors offered significantly increased volumes of aid – between 1996 and 1999 aid flows rose from 0.4 to 1.6 per cent of GNI and from 2.1 to 7.4 per cent of central government expenditures. This in turn helped the government to maintain at least a modest development budget despite a massive increase in public sector debt repayments. At the same time, however, in helping the Indonesian government to manage the crisis, donors made some serious mistakes. For instance, the IMF, which was called in to help the government deal with the crisis in late 1997, was widely criticised for prescribing the wrong economic medicine: the region, it was argued, did not need 'wanton budget cutting, credit tightening and emergency bank closures' but 'stable or even expansionary monetary and fiscal policies to counterbalance the decline in foreign loans' (Sachs 1997). By insisting on the former, it was argued, the IMF severely worsened the contractionary effects of the crisis (Radelet and Sachs 1998). Furthermore, the social safety net activities in education and health that were such a key part of donor strategies for protecting the poor during the crisis appear to have been only partially effective, due mainly to problems with the leakage of funds.

One further point should be made in relation to the role of donors in Indonesia since the late 1960s. A key limitation on the effectiveness of foreign aid has been the fact that a significant proportion of it was aimed at serving the commercial objectives of private business groups from donor countries as much as for developmental objectives. This was particularly the case in relation to Japan's aid programme, by far the largest aid programme in Indonesia, although it was also a feature of some other countries' aid programme, most notably Australia. A key objective of Japanese aid to Southeast Asia during the New Order period was to promote Japanese trade and investment and coordinate 'the commercial agendas of private sector actors … with the strategic and economic agendas of the economic ministries' (Arase 1994: 172 as quoted in Beeson 2001: 289). Despite this, however, Japan's foreign aid programme does not appear to have worked entirely against Indonesia's economic development, especially insofar as it served to facilitate deeper integration with the Japanese economy.

6 Conclusion

Since the mid-1960s, Indonesia has experienced dramatic fluctuations in its performance *vis-à-vis* turnaround. During the mid-1960s, Indonesia's economy was in crisis and political instability led to massive violent conflict following the rise of the New Order as the military sought to wipe out its main political rival, the PKI. From the late 1960s, however, the country entered a period of turnaround. Between the late 1960s, the country's economy grew strongly, human development proceeded apace, and the country experienced relative political stability. By the early 1990s, Indonesia had made such dramatic economic gains that it was widely regarded as a 'miracle' economy (World Bank 1993a). In the late 1990s, this period came to end, with the onset of a severe economic crisis that led to a massive contraction in the economy and a resurgence in violent conflict in various parts of the country. It has been argued here that Indonesia's fluctuating performance regarding the turnaround has reflected the orientations, abilities and political skills of the country's political leaders during this time, particularly its two Presidents, Sukarno and Suharto; struggles between the main social and organisational forces within the country and the emergence of new social forces; the nature of the country's geopolitical and geo-economic environment; and 'the nature of economic shocks'.

Whether Indonesia can return to high levels of economic growth, restore political stability, and promote further human development in the future remains to be seen. However, there are good reasons not to be overly optimistic. Virtually none of the conditions that facilitated turnaround in Indonesia during the first decades or so of the New Order exist at present. Presidential leadership since Suharto has been weak, reflecting the decline in presidential authority that has accompanied the process of democratisation and constitutional change since then, as well as the fact that post-Suharto presidents have had far fewer economic resources at their disposal. None of the individuals who have held the presidency since Suharto – Habibie, Wahid, Megawati, Yudhoyono – have shown Suharto's willingness to listen to technocratic advisers. Indeed, although the technocrats – or at least a new generation of technocrats – continue to play a role in government, as Boediono's reasonably long tenure as Finance Minister attests, they have found themselves increasingly marginalised as democratic competition has led to increased appeal to radical populist sentiment (Rosser *et al.* 2004; Hill and Basri 2000). Furthermore, the crisis has not led to the political victory of a particular set of social forces, as the mid-1960s did. The fractured nature of power in post-Suharto Indonesia has meant that the country's political leadership has often faced strong political resistance to reform initiatives. Finally, Indonesia faces a much less favourable geopolitical and geo-economic environment than it did during the 1960s and 1970s. As noted above, Indonesia does not have the geo-strategic importance nowadays that it had during the Cold War era, although the US's recent prosecution of a 'War on Terror' may change that, given the country's recent problems with terrorist attacks by radical Islamic groups. In addition, the East Asian region, while still the most economically dynamic in the world, is growing at a much slower rate than it was at the height of the "East Asian miracle", limiting the flow of economic opportunities to Indonesia from its neighbours.

Notes

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1. The most important periods in Indonesia's history, as far as the comparative purpose of this project is concerned, are the late 1960s and 1970s (when turnaround occurred) and the late 1990s (when the partial reversal occurred). Hence, the article concentrates on these periods and the developments that preceded them and does not examine in detail developments since the late 1990s, as interesting as these have been for other reasons.

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